ECONOMIC UPDATE

REGIONS

January 26, 2018

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Q4 2017 GDP: No Three-Peat, But The Details Are Solid

- The BEA's initial estimate shows real GDP grew at an annualized rate of 2.6 percent in Q4 2017
- Consumer spending, business and residential fixed investment, and government spending were the main drivers of Q4 growth
- For 2017 as a whole, real GDP grew by 2.3 percent, following growth of 1.5 percent in 2016 and 2.9 percent in 2015

Apparently "three-peats" are just as hard to come by in the realm of economic growth as they are in the sports world. The BEA's initial estimate for Q4 2017 puts real GDP growth at 2.6 percent, falling short of the 3.0 percent we and the consensus expected. Had growth come in as expected, it would have marked a third consecutive quarter of growth at or above the 3.0 percent mark, a feat last accomplished in 2004/05. Still, as is the case with any given data release, the headline number is far less significant than the underlying details, and the details of the report on Q4 GDP are solid. Most encouragingly, the run of double-digit growth in business outlays on equipment and machinery continued and residential investment bounced back from a tepid Q3. The GDP data are of course a bit lagged, but they do affirm a point we've been making over the past few months – the U.S. economy did indeed head into 2018 with a good deal of positive momentum.

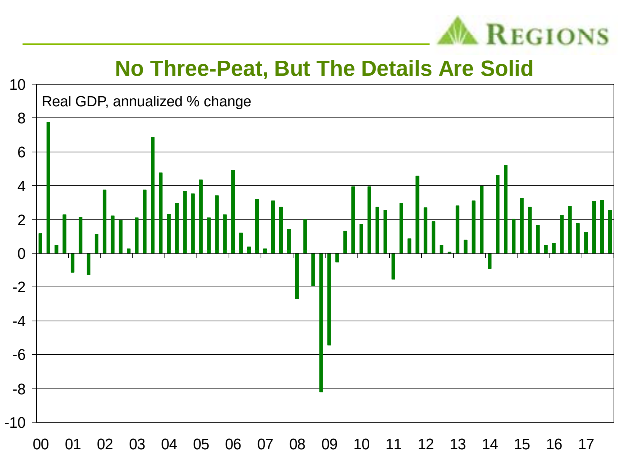
As we do each quarter, we'll note that the initial estimate of GDP growth in any given quarter is based on highly incomplete source data and, as such, is prone to sizeable revision. Still, as the data now stand, real GDP grew by 2.25 percent for 2017 as a whole. While this is pretty much in line with the middling average pace of growth seen since the end of the 2007-09 recession, the momentum the economy carried into 2018 means the bar is set much higher for growth this year.

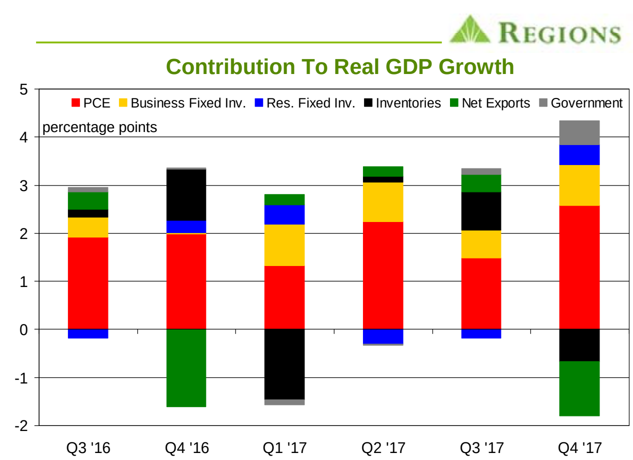
Real consumer spending grew at an annualized rate of 3.8 percent in Q4, the fastest growth since Q2 2016. Inflation adjusted spending on goods grew at an annualized rate of 8.2 percent, with an eye-popping growth rate of 14.2 percent in spending on consumer durables, the fastest such growth since Q3 2009. While post-hurricane replacement demand spurred motor vehicle sales in Q4, spending was strong across the board across all categories of consumer durables. Real spending on nondurable consumer goods grew at an annualized rate of 5.2 percent while spending on household services grew at a 1.8 percent rate, up from 1.1 percent growth in Q3 but still soft. Growth in consumer spending added 2.58 points to top-line real GDP growth in Q4.

Consumer spending was by no means the only strong spot in the Q4 data, as real private domestic demand (which accounts for consumer spending and private sector fixed investment) grew at an annualized rate of 4.6 percent, the fastest growth since the middle two quarters of 2014. Real residential fixed investment grew at an annualized rate of 11.6 percent, though it is worth noting that single family construction is the primary driver of growth here as real outlays on multi-family construction fell for a third consecutive quarter. Real business fixed investment grew at an annualized rate of 6.8 percent, with spending on structures up at a 1.4 percent rate, spending on intellectual property products up at a 4.5 percent rate, and spending on equipment and machinery up at an 11.4 percent pace, slightly ahead of our forecast. As a whole, business fixed investment added 0.84 points to top-line real GDP growth in Q4. While we have for some time been pointing to growth in business investment as the single most encouraging element of the economic data, it is also the case that business investment has been a notable laggard over the course of an expansion marked by not only its duration but also by its lack of vigor. In other words, there is still plenty of catching up to do for business investment, and we expect the strength seen over the final three quarters of 2017 to persist in 2018.

Elsewhere, a slower pace of inventory accumulation in Q4 than in Q3 resulted in inventories taking 0.67 points off of top-line growth. A much wider trade deficit – exports of U.S. goods rose at a double-digit rate but inventories of goods grew even faster – resulted in trade taking 1.13 points off of top-line real GDP growth. Conversely, the fastest growth in combined (local, state, and federal) government spending since Q2 2015 added 0.50 points to top-line real GDP growth in Q4.

The U.S. economy entered 2018 with positive momentum. The keys to this being sustained are continued robust growth in business investment and policy makers not hurling obstacles, such as restrictive trade policies, in the economy's path. If we can stay out of our own way, the economy should see a meaningful late-cycle acceleration in 2018.





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